ROYSE LAW

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Comments: International Tax Reform Working Group

Dear Representatives Nunes and Blumenaur,

The Silicon Valley of Northern California has become one of the most desirable locations in the world for new companies to develop innovative technologies, create jobs and contribute to the nation's productivity. As business has become increasingly global and income has become more mobile, US businesses face increasing competition from companies based in other countries. However, companies in the US now find themselves paying the highest tax rates in the world. The US is not only unattractive in terms of tax rates, it is also unattractive in its method of taxing on a worldwide rather than territorial basis.

The last major tax reform in the United States was the Tax Reform Act of 1986 ("TRA '86"). Since that time, whole industries have emerged that did not exist before. Some of the largest companies in America could not have even been conceived of in 1986. Taxable income has become "mobile" and workers transient in ways that our tax laws are ill-equipped to deal with. More significantly, foreign businesses have become much more competitive and mobile.

While global tax rates have decreased and competition has increased, the US tax system has changed very little in some important ways. Practitioners struggle to apply decades old statutes and antiquated regulations to new transactions and business relationships. Having represented international startup and tech companies in Silicon Valley since 1991, I observe that even startup companies now find it worthwhile to structure their operations offshore and limit the involvement in the United States. This development is significant, since much new technology is developed and exploited in a startup environment. When the startup community leaves the US, the future of technology development and innovation also leaves the US. Much of the industrialized world awaits this migration with incentives, funding and, importantly, low tax rates.

Clearly, fundamental reform is needed to remove the negative incentives artificially created by our tax system. The time has come to revamp both the tax rates and the tax system.

Given the existing tax environment, I applaud the efforts of the Committee and agree with the proposed approach that would:

1. Lower corporate tax rates to no more than 25%;
2. Tax US companies on a territorial basis by granting a participation exemption for dividends received from foreign subsidiaries; and

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3. Limit deferral of tax on excess foreign intangible income.

I believe that the proposed changes, if enacted into law, would increase the US tax base by incentivizing global startups to locate in the US and encouraging multi-nationals to remain in the US.

While the proposals go a long way towards increasing America's global competiveness, they do not address the problem of creeping state tax jurisdiction. In recent years, many states have steadily increased the tax burden on out of state and foreign companies operating within their borders. In some states, such as California, even a lowered 25% federal tax corporate rate will result in an excessive combined federal and state rate.

High state tax rates, when combined with the federal rates, discourage companies from locating in those states, even though the location of their markets, talent and financing may make those states logical places to establish themselves. Sometimes companies that are taxed out of a state will locate in another state; often, in my experience, they will simply leave the country, taking their talent, jobs and technology with them.

Some states have not only discouraged inbound investment through tax rates; many states have become notoriously more aggressive about finding sales and income tax nexus for imposing tax on international technology companies. While the states' ability to impede interstate commerce is limited by the Commerce Clause of the US Constitution, no law exists that prevents excessive state tax rates or compels states to comply with tax treaties negotiated with foreign countries.

I will, within the next several days, submit comments proposing that Congress act to limit the ability of states to frustrate the efforts of Congress to encourage companies to do business in the US. In particular, I will propose the consideration of the following initiatives:

1. A federal limitation on the maximum rate of tax on income that states may levy;
2. The establishment of a uniform income tax nexus standard for information technology companies;
3. A Code-conformity requirement with respect to certain federal taxes designed to encourage innovation and investment; and
4. A requirement that the states comply with treaty obligations negotiated by the United States with foreign countries.

The idea of Congress regulating state taxes may at first seem unusual, but it is worth noting that there is precedent for federal oversight when states have over-reached on tax issues. For example, P.L. 104-95 prohibits state taxation of certain pension income of nonresidents. I am mindful of the significant constitutional issues involved in the regulation of state taxes, and am confident that, in view of the significant adverse effect state tax policies may have on international commerce, Congress can find constitutional authority in the Necessary and Proper Clause.

These ideas will be further developed in additional comments.

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